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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1907

No. 633

THE KANSAS CITY SOUTHERN RAILWAY
COMPANY,

Petitioner,

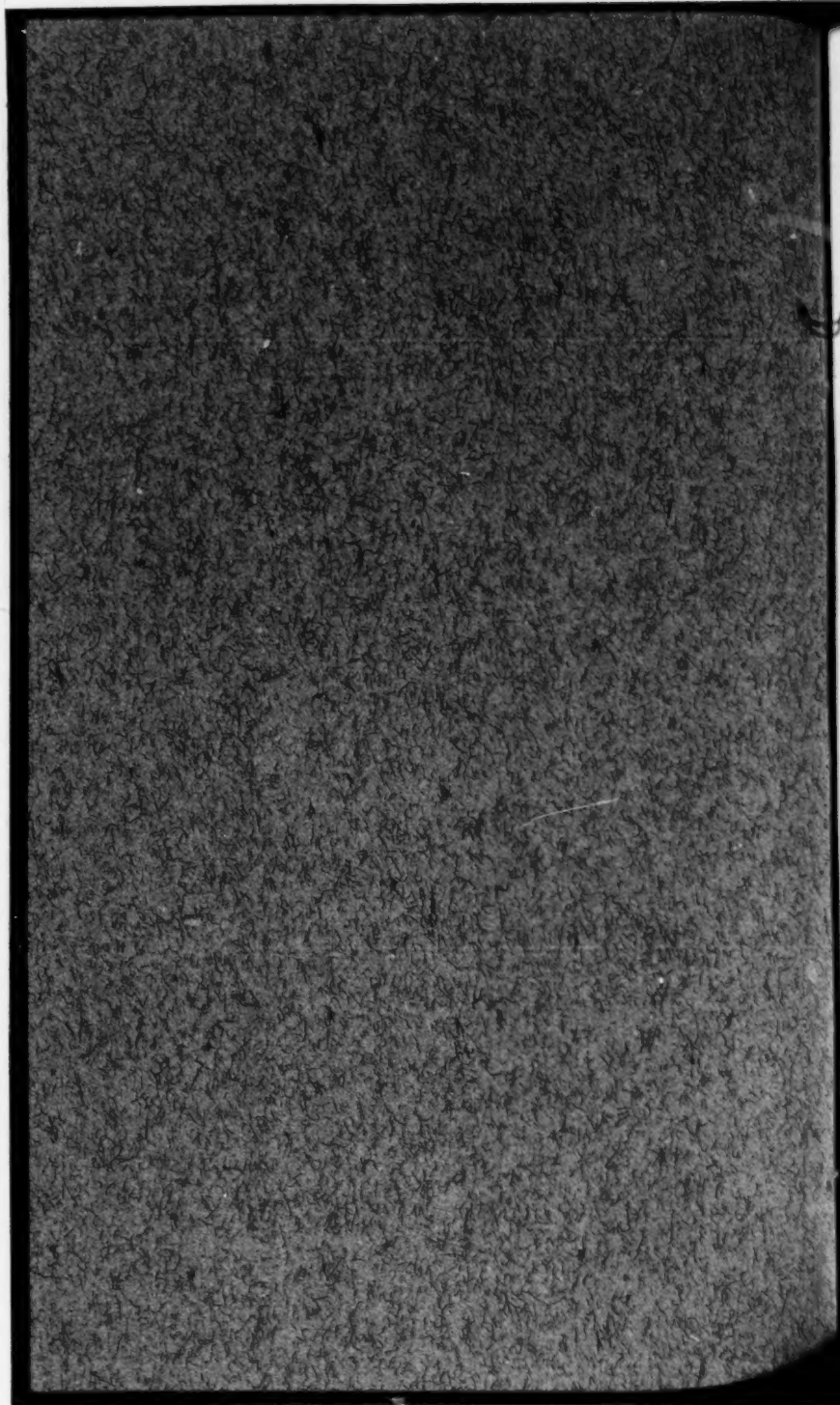
vs.

OTHO A. COOK, COMMISSIONER OF REVENUE, STATE OF
ARKANSAS,

Respondent.

PETITION FOR WRIT OF HABEAS CORPUS TO THE
SUPREME COURT OF ARKANSAS AND BRIEF IN
SUPPORT THEREOF.

JOSEPH R. BROWN,
Counsel for Petitioner.



INDEX

SUBJECT INDEX

	Page
Petition for writ of certiorari	1
Summary statement	1
The issue	3
Facts	3
Decision of the Arkansas Supreme Court	4
Reasons for allowance of the writ	5
1. The Arkansas Supreme Court's Decision is contrary to the law as construed by this Court	5
2. The Arkansas decision subjects interstate railroads in Arkansas to arbitrary State Tax Laws irrespective of the burdens imposed thereby	5
3. The Arkansas decision deprives peti- tioner and others similarly situated of protection of the Federal Constitution and laws	5
Brief in support of petition	7
Opinion of the court below	7
Jurisdiction	7
Statement of facts (see petition)	8
Specifications of errors	8
Argument	9
I. The Arkansas Supreme Court erred in reversing the trial court judgment and refusing to follow controlling Federal decisions	9
II. Use of respondent's formula resulted in illegally taxing petitioner's income from without the State	13
Conclusion	16
Appendix	17

TABLE OF CASES

	Page
<i>Dunklin v. McCarroll</i> , 199 Ark. 800.....	16
<i>Fleming et al. v. Okla Tax Comm.</i> (10CCA), 157 F. (2d) 888.....	8, 14
<i>Hans Rees' Sons v. N. C.</i> , 283 U. S. 123.....	8, 9, 12
<i>Norfolk & Western R. Co. v. N. C.</i> , 297 U. S. 682.....	9
<i>N. C. & S. L. R. v. Browning</i> , 310 U. S. 362.....	8, 10
<i>So. R. Co. v. Ky.</i> , 274 U. S. 76.....	8, 9, 12
<i>S. L. S. W. R. Co. v. Ark.</i> , 235 U. S. 350.....	8, 10
<i>Wallace v. Hines</i> , 235 U. S. 66.....	8, 9

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**THE KANSAS CITY SOUTHERN RAILWAY,
COMPANY,**

Petitioner,

vs.

OTHO A. COOK, COMMISSIONER OF REVENUES,

Respondent

**PETITION FOR WRIT OF CERTIORARI TO ARKANSAS
SUPREME COURT**

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States of America:

The Petition of The Kansas City Southern Railway Company respectfully shows:

Summary Statement

Petitioner brought this suit in the Pulaski Chancery Court to recover Arkansas income taxes for 1941 and 1942 paid under protest. Judgment was rendered in peti-

tioner's favor by said trial court. The Arkansas Supreme Court reversed the trial court judgment.

Petitioner duly filed Arkansas income tax returns for the years 1941 and 1942, and paid taxes thereunder. It computed net incomes by deducting from Arkansas gross revenues, actual operating, maintenance and miscellaneous expenses within the state, as well as general expenses apportioned on a car, train and engine-mile basis. Petitioner had always used said formula in calculating operating, maintenance and miscellaneous expenses in Louisiana, Texas, Oklahoma, Arkansas, Kansas and Missouri, the six states traversed by its line of railroad. Never before had the formula been questioned.

Respondent, Arkansas Commissioner of Revenues, re-computed by the statutory formula (Pope's Digest, Sec. 14026(e))¹ the taxes for said years 1941 and 1942, and made deficiency levies accordingly. Petitioner paid said deficiency levies under protest, and brought this suit to recover amounts so paid, as above stated, charging imposition of said deficiency levies violated the due process clause of the Federal Constitution, Fourteenth Amendment.

The case was tried May 9, 1946, and taken under advisement. December 7, 1946, the trial court found deficiency assessments for both the years involved had been illegally levied and collected, and should be refunded. April 18, 1947, respondent appealed the case. November 3, 1947, the Arkansas Supreme Court reversed the trial court, adjudging deficiency levies made by respondent against petitioner for both the years 1941 and 1942 were legally assessed and collected.

Petitioner, November 17, 1947, duly filed petition for rehearing. Said petition was overruled December 1, 1947. In due time petitioner presents herewith certified copy of

¹ Appendix, Page 17.

the entire record and proceedings in the Chancery Court of Pulaski County and Arkansas Supreme Court.

This Petition for Writ of Certiorari is filed under Title 28 U. S. C., Sec. 344 par. (b), Sec. 237, Judicial Code as amended.

The Issue

The issue is whether the Arkansas Law prescribing an arbitrary formula for computing state income taxes against interstate railroads, should, in all cases, be adjudged constitutional, although use of said formula, in the instant case, imposed levies grossly in excess of a more accurate formula, and taxes petitioner's income earned without the state.

Facts

Petitioner over a period of years had worked out a formula for allocating net income to each of the six states its railroad traverses. Accuracy of the formula is self-evident. Respondent conceded its accuracy, except the localizing of extra Arkansas Full Crew expenses and costs of operation over heavy Arkansas grades. The trial court adjudged the formula was accurate in all respects, and decreed the Arkansas Law unconstitutional as applied to petitioner's 1941 and 1942 operations, because it imposed, both years, grossly excessive tax burdens upon petitioner, and taxed net income from without the state.

Under said formula, track and station expenses are localized, i.e., charged to the state where located. Cost of equipment repairs (engines, cars, etc.) is apportioned to the state on an equipment mileage basis, as well as supervisory and general traffic expenses; i.e., said expenses are allocated in the proportions repaired equipment moves in the state to system movements. Extra expense of complying with the Arkansas Full Crew Law is charged to Arkansas, as

well as additional expense of double header engines required to pull trains over the state's mountainous areas.

By said formula, petitioner's 1941 operating expenses were computed as \$2,239,472.46; and its 1942 operating expenses \$3,794,353. Parties agreed petitioner's correct gross revenues allocable to Arkansas for said years were \$3,248,596 and \$4,932,871, respectively.

In 1929 the Arkansas legislature enacted a law (verbatim like a North Carolina statute), requiring interstate railroads in computing state net income for tax purposes, to multiply the state gross revenues by the system operating ratio, and deduct from said gross revenues the product. Use of said statutory formula increased petitioner's 1941 Arkansas net income from \$41,604.72 to \$241,323.88, and its taxes from \$1,630.24 to \$11,616.19. 1942 Arkansas net income was thereby increased from \$40,406.76 to \$426,234.31, and taxes from \$1,570.34 to \$20,861.72.

In other words, petitioner's 1941 Arkansas net income, computed by petitioner's formula was \$41,604.72, whereas it was six times that amount, or \$241,323.88, computed by the Arkansas statutory formula. 1942 Arkansas net income computed by petitioner's formula was \$40,406.76, whereas it was more than ten times that amount, or \$426,234.31, computed by the Arkansas statutory formula. In the first case, petitioner's 1941 taxes were increased from \$1,630.24 to \$11,616.19. In the second, 1942 taxes were increased from \$1,570.34 to \$20,861.72.

Decision of the Arkansas Supreme Court

The Arkansas Supreme Court adjudged, contrary to the evidence and admission of respondent and findings of the trial court, that the Arkansas Law and respondent's formula for apportioning operating expenses and car rental costs, were not arbitrary, and use thereof did not result in tax-

ing petitioner's net income from without Arkansas, and did not impose taxes grossly in excess of petitioner's more accurate formula. It further decreed, contrary to the law, that expenses of complying with the Arkansas Full Crew Statutes, and extra costs of operating over Arkansas mountains, should not be localized.

Reasons for Allowances of the Writ

Petitioner respectfully urges the writ should issue because:

1. In reversing said trial court judgment the Arkansas Supreme Court erroneously decided a Federal Constitutional question adversely to petitioner, and, it is believed, contrary to the law as construed by this Court.

2. The matter at issue is of great importance, since it involves the proper method of apportioning state income taxes of interstate railroads from year to year. A determination of said issue is essential in order that petitioner and others in its class may know whether they should be subjected to arbitrary state tax laws, and, irrespective of the burdens imposed thereby, denied recourse to Federal Courts.

3. The decision and opinion of the Arkansas Supreme Court deprive petitioner and others similarly situated of protection of the Federal Constitution and Laws.

Attached hereto is petitioner's brief in support of this petition. Reference is respectfully made thereto for discussion of the law and authorities in support of the right claimed on behalf of petitioner.

Wherefore, petitioner respectfully requests that the Court issue a Writ of Certiorari to the Supreme Court of the State of Arkansas to certify and send to this Court a full and complete transcript of the record herein, to the end

that the cause may be reviewed and decided according to law; that the judgment may be reversed with costs, and for such other and further relief as may be appropriate in the premises.

JOSEPH R. BROWN,
Counsel for Petitioner.

STATE OF MISSOURI,
County of Jackson, ss:

Joseph R. Brown under oath states he is counsel for petitioner, The Kansas City Southern Railway Company, that he prepared the foregoing petition, and allegations thereof are true as he verily believes.

JOSEPH R. BROWN. (Seal.)

Subscribed and sworn to before me this February
13th, 1948. My commission expires November 30,
1949.

E. R. GIBBINS.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

I

Opinion of the Court Below

The Arkansas Supreme Court's Opinion (R. 69-77) reported in 205 S. W. (2) 441, was handed down November 3, 1947, and the judgment became final December 1, 1947.

II

Jurisdiction

1. Petition for Writ of Certiorari is sought under Sec. 237 Judicial Code as amended (28 U. S. C. A. 344 (b)).

2. The Judgment became final December 1, 1947, when petitioner's petition for rehearing was overruled (Pope's Ark. Dig. Sec. 2777).

3. Petitioner paid, under protest, 1941 and 1942 Arkansas income tax deficiency levies, and brought this suit to recover said payments in the Chancery Court of Pulaski County, Arkansas, under Pope's Ark. Dig. Sec. 14055.

4. Petitioner relies upon the following points as the basis of this Court's jurisdiction:

(a) The Arkansas Supreme Court's reversal of the trial court judgment disapproving the use of respondent's formula (Pope's Ark. Dig. Sec. 14026 (e)) in computing, in the circumstances, income taxes against petitioner for both the years 1941 and 1942, violated petitioner's Federal Constitutional rights, and was contrary to Federal Law.

(b) The evidence established, respondent admitted, and the trial court adjudged, that petitioner's formula for computing said taxes was more accurate than the statutory

formula, and that use of said statutory formula in the instant case, imposed taxes on net incomes earned without Arkansas grossly in excess of impositions apportioned under petitioner's more accurate formula. Since the trial court judgment was predicated upon substantial evidence, the Arkansas Supreme Court erred in reversing said judgment.

5. Cases sustaining this court's jurisdiction:

N. & W. R. Co. v. North Carolina, 297 U. S. 682;
Hans Rees' Sons v. North Carolina, 283 U. S. 123;
So. Ry. Co. v. Kentucky, 274 U. S. 76.
Wallace v. Hines, 253 U. S. 66;
N. C. & S. L. R. v. Browning, 310 U. S. 362;
S. L. S. W. R. Co. v. Arkansas, 235 U. S. 350;
Fleming, et al v. Oklahoma Tax Commission (10 CCA),
 157 F(2) 888.

III

Statement of Facts

Facts are stated in the petition for Writ of Certiorari (*supra* 1).

IV

Specifications of Errors

The Arkansas Supreme Court erred in reversing the trial court judgment adjudging use of the Arkansas statutory formula and the method used by respondent for computing petitioner's 1941 and 1942 income taxes under the facts, imposed tax burdens upon petitioner grossly in excess of the more accurate formula of petitioner and taxed net income earned without Arkansas.

ARGUMENT

I

The Arkansas Supreme Court Erred in Reversing the Trial Court Judgment and Refusing to Follow Controlling Federal Decisions

The Arkansas trial court adjudged respondent's deficiency income tax levies against petitioner for both 1941 and 1942, illegal, and ordered same refunded. The court predicated its decision upon *Norfolk & Western R. Co. v. North Carolina*, 297 U. S. 682. In said case, this Court declared a North Carolina statutory formula from which the Arkansas Law was taken (Pope's Ark. Digest Sec. 14026(e)), would be unconstitutional if an interstate railroad proved its application were arbitrary and oppressive. It said (685):

"A formula not arbitrary on its face or in its general operation may be unworkable or unfair when applied to a particular railway in particular conditions A segment of the line may operate under handicaps resulting from the nature of the traffic, the topography of the country, the maladjustment or inadequacy of passenger or freight tariffs in one district or another."

The Court added,

"If this is made to appear with an ensuing burden on the taxpayer grossly in excess of the results of a more accurate apportionment, the statute to that extent is an unconstitutional endeavor to tax the income of a business in another jurisdiction."

In support of the conclusion the Court cited *Hans Rees' Sons v. North Carolina*, 283 U. S. 123, and *So. Ry. Co. v. Kentucky*, 274 U. S. 76. See also *Wallace v. Hines*, 253 U. S. 66. The Arkansas statutory formula clearly, in the

circumstances, projects taxing power beyond the State's borders. For the years 1941 and 1942, it plainly taxes plaintiff's income in the State of Louisiana; income derived from the great volume of oil moving primarily in Louisiana from Port Arthur, Texas, to Shreveport, and which never touched Arkansas. It plainly omitted to charge to Arkansas the expense of complying with the State's Full Crew Law. It plainly omitted traffic conditions chargeable solely to the State of Arkansas. In *N. C. & S. L. R. v. Browning*, 310 U. S. 362, the court adjudged a State could not use a formula to project taxing power beyond its borders. The Arkansas franchise tax law was adjudged valid, because its specific terms restricted the taxing power to railroad operations within the State. *S. L. S. W. Ry. Co. v. Arkansas*, 235 U. S. 350.

Petitioner's complaint contained two causes of action (R. 2). The first involved alleged income tax levies for 1941, the second for 1942. Each cause of action was divided into 3 counts. The second counts, because of small amounts involved, were voluntarily dismissed. The first counts contest validity of use of the Arkansas statutory formula, both years, in calculating operating expenses and deducting same from Arkansas gross revenues to ascertain net operating income.

The third counts, both causes of action, contest the legality of use of Arkansas revenue ratios in computing State car rental expenses.

Respondent agreed petitioner's 1941 and 1942 gross revenues were \$3,248,596 and \$4,932,871, respectively (R. 27, 26). In ascertaining operating expenses, petitioner, as stated, localized expenses of complying with the Arkansas Full Crew Law, and extra costs of pulling double header trains over heavy Arkansas grades, as well as sums spent on track and station repairs. Cost of equipment repairs (engines, cars etc.) petitioner apportioned to the State on

an equipment mileage basis. In like manner it apportioned supervisory and general traffic expenses (R. 25).

By said formula petitioner's 1941 and 1942 operating expenses aggregated \$2,239,472.46 and \$3,794,352, respectively (R. 27, 22). Computed by the statutory formula, said expenses aggregated \$2,081,050.60 and \$3,036,675.39 respectively (R. 27, 26). The difference increased net operating revenues and income taxes proportionately. The gross hardship imposed upon petitioner each year by use of the statutory formula resulted primarily from the large amount of freight traffic transported in the war effort, beginning in 1941 and increasing materially in 1942. The greater part of said traffic moved over petitioner's railroad from the world's largest oil refineries in Southern Texas and Louisiana to Shreveport, Louisiana, and Texarkana, Texas, and from said points over connecting carrier lines for delivery to Atlantic ports, and thence by ships to war zones in Africa and Europe.

Uncontradicted proof established that petitioner's accurate 1941 Arkansas operating ratio was 68.94% (R. 22), while the system ratio was 64.06% (R. 7, Ex. B); that its accurate 1942 Arkansas operating ratio was 76.92%, as compared with a system ratio of 61.56% (R. 11, Ex. D). Differences were due largely to the above mentioned heavy war tonnage that moved under high rates and did not touch Arkansas on petitioner's rails, and to low density of low rate traffic in Arkansas, producing less revenue per ton-mile of freight moved in the State, as compared with system movements (R. 45). Said factors added to heavier topographical operating costs, plus costs of complying with the Arkansas Full Crew Law, increased state operating ratios and lowered system ratios. Much greater average net ton-mile revenues were derived from traffic moving over petitioner's railroad without Arkansas than within. And since

no part of the increased and more remunerative war traffic touched Arkansas, Arkansas could not levy a tax on petitioner's net income accruing therefrom.

This Court has specifically decreed the cost of pulling heavy grades in a State should be localized. It has further adjudged a State with a low traffic density should bear the resulting burden of increased net income.

In *Hans Rees' Sons v. North Carolina*, 283 U. S. 123, 133, the Court said:

"... the fact that the corporate enterprise is a unitary one, does not mean that for the purpose of taxation the activities which are conducted in different jurisdictions are to be regarded as 'component parts of a single unit' so that the entire net income may be taxed in one state regardless of the extent to which it may be derived from the conduct of the enterprise in another state."

The Court then added (134):

"... that a tax could lawfully be imposed upon a foreign corporation with respect to the 'proportionate part of its total net income . . . attributable to the business carried on within the state'. When, as in this case, there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within its own borders, and the question is necessarily one of apportionment, evidence may always be received which tends to show that a state has applied a method, which, albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction."

And in *Norfolk & Western R. Co. v. North Carolina* (above) the Court adjudged a formula may be unworkable when applied to a railway in particular conditions. It added that such conditions could result from the nature of the traffic, the topography of the country, or the inadequacy of freight tariffs. In *So. R. Co. v. Kentucky*, 274 U. S. 76, the

Court condemned a State law in principle like the Arkansas law. It said (84):

“ . . . as the direct earnings per mile of the lines (in Kentucky) . . . are so much less than the average of the system, it is plain that the amount adjudged to have been omitted was arbitrarily excessive and included values of system property beyond the limits of Kentucky.”

II

Use of Respondent's Formula Resulted in Illegally Taxing Petitioner's Income from Without the State

For simplifying allocation of net income of interstate railroads, the Arkansas Law was enacted. That said law provides an arbitrary method for allocating taxable income is self-evident. This court has adjudged, however, that a statute, although arbitrary, will not be outlawed if its application does not impose upon a taxpayer burdens grossly in excess of a more accurate formula.

Use of the Arkansas law by respondent's calculation decreased petitioner's 1941 operating expenses from \$2,239,472.46 to \$2,081,050.60, and its 1942 operating expenses from \$3,794,353.39 to \$3,036,675.39. Thereby net operating incomes were proportionately increased. Use of respondent's formula decreased petitioner's 1941 non-operating expenses for car rental from \$212,303 to \$174,856.25 and said 1942 expenses from \$386,449 to \$313,212.90. Net income for each year was thereby increased proportionately.

Application of the Arkansas law and use of revenue ratios in computing car rental expenses resulted in increasing petitioner's 1941 net income from \$41,604.72 to \$241,323.88, and 1942 net income from \$40,406.76 to \$426,234.31. Said increases augmented 1941 taxes from \$1630.24 to \$11,616.19, and 1942 taxes from \$1570.34 to \$20,861.72.

Petitioner respectfully submits the Arkansas trial court correctly adjudged said increases grossly burdensome and

illegal; that the Arkansas Supreme Court erred in reversing said judgment. *Norfolk & Western R. Co. v. North Carolina* (supra); *So. Ry. Co. v. Kentucky* (supra); *Fleming et al. v. Oklahoma Tax Comm.* (10 CCA) 157 F(2) 888.

The Arkansas Supreme Court prefaced (R. 69) its opinion by stating:

“While discussions relating to these items (deductions) were in progress it was found that a determination of the correct method of accounting for one year would be decisive of . . . the second year; hence for the purpose of this opinion 1941 alone is discussed.”

Discussions alluded to, it must be assumed, were by members of the Court, but certainly the court erred in concluding a decision of the first cause of action involving 1941 taxes, should govern 1942. The court might conceivably have found taxes imposed by respondent's formula in 1941 were not grossly in excess of taxes computed by petitioner's more accurate formula, whereas, such could not have been true in 1942. In the former case, the difference in the operating ratio used in computing net income was 4.88%; whereas, in the latter, it was 15.36%. In the first case petitioner's taxes were increased 500%, in the second 1200%.

It is significant that the Arkansas Supreme Court, in support of its conclusion that use of the statutory formula in computing petitioner's income taxes in 1941 and 1942 was legal, cited only the case of *Fleming et al v. Oklahoma Tax Commission* (above). It made no reference to *Norfolk & Western R. Co. v. North Carolina* (above), or other cases relied upon by petitioner. The Arkansas Court was clearly in error in adjudging expense of complying with the Arkansas Full Crew Law a system expense, as well as extra costs of operating over the state's heavy grades. It also erred in adjudging the state should not bear the burden of its low traffic density.

Respondent's apportionment of Arkansas car rental costs (proper deductions from net operating income in ascertaining state net income) for both 1941 and 1942, obviously resulted in taxing petitioner's income from without the state. In computing said amounts for 1941, he multiplied the Arkansas revenue ratio of 16.95% by petitioner's system car rental costs, and charged the product to Arkansas car rental for said year. The 1942 expenses were computed by the revenue ratio of 14.37%.

Respondent's 1941 Arkansas revenue ratio was obtained by dividing petitioner's 1941 gross revenues of \$3,248,596, by system gross revenues aggregating \$19,163,035.29. Its 1942 ratio was computed by dividing 1942 gross revenues of \$4,932,871 by system gross revenues totaling \$34,316,347.76. It is difficult to comprehend how the state revenue ratio could have the remotest bearing upon car hire expense. Gross revenues represent money received, whereas car hire expense is money paid out. Arbitrary use of said revenue ratio decreased petitioner's expenses in 1941 and 1942, by the sums referred to, and increased, proportionately its Arkansas net income.

Petitioner allocated car hire expense by computing the total number of miles rented cars moved over the system, as compared with the mileage in Arkansas, and apportioned the expense accordingly (R. 28). The accuracy of the formula is obvious.

By petitioner's formula the 1941 Arkansas ratio was 20.58%, and the 1942 ratio 17.73%. Thereunder petitioner charged to Arkansas in 1941, \$212,303, and in 1942, \$386,449. Correctness of the formula was established by the fact that total freight car rental expenses allocated thereunder to each of the six states served by petitioner, equalled system car rentals. Therefore, under counts 3, both causes of action, the Arkansas Supreme Court judgment imposed a

tax on \$37,446.75 of petitioner's net income earned without Arkansas, and on \$73,236.10, of its 1942 net income so earned.

This Court, as stated, has adjudged a state may not project taxing powers beyond its borders. *Hans Rees' Sons v. N. C.* (*supra*); *Wallace v. Hines* (*supra*); *N. C. & S. L. R. Co. v. Browning* (*supra*); and the Arkansas Court has so held. *Dunklin v. McCarroll*, 199 Ark. 800.

Conclusion

Respondent conceded accuracy of petitioner's formula in computing its 1941 and 1942 net incomes. The trial court adjudged from competent and undisputed evidence the correctness of said formula. Respondent conceded, and the trial court adjudged, that respondent's calculations increased petitioner's Arkansas net income in 1941 from \$41,604.72 to \$241,323.88, and 1942 net income from \$40,406.76 to \$426,234.31. The trial court adjudged said increases imposed upon petitioner burdens grossly excessive. It decreed said increases, in the circumstances, violated petitioner's constitutional rights.

Petitioner submits the trial court was correct. It submits an increase of 500% (from \$1630.24 to \$11,616.19) in 1941 taxes, and 1200% (from \$1570.34 to \$20,861.72) in 1942 taxes, should have been adjudged grossly excessive. It submits the Arkansas Supreme Court erred in reversing said trial court judgment.

Issues herein presented are important, and since the Arkansas Supreme Court decision is in direct conflict with numerous decisions of this Court, petitioner submits a Writ of Certiorari should be granted.

Respectfully,

JOSEPH R. BROWN,
Counsel for Petitioner.

APPENDIX

Pope's Arkansas Digest Section 14026 (e):

"Mode of determining taxable income of utilities. The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the 'net income' of such corporation as shown by their records kept in accordance with that standard of classification of accounts, when their business is wholly within the jurisdiction of the State.

When the business of such utility is partly within and partly without the State, their net income within the jurisdiction of this State shall be ascertained by taking their gross 'operating revenues' within the State, including in this gross 'operating revenues' within the State the equal mileage proportion within the State of their interstate business and deducting from their gross 'operating revenues' the proportionate average of operating expenses or operating ratio for their whole business as shown by the Interstate Commerce Commission standard classification of accounts.

To the net operating revenues thus determined shall be added revenues from miscellaneous operations within the State and other non-operating income from sources within the State, together with a proportionate part based upon the ratio of gross operating revenues from sources within the State to their entire gross operating revenues of all non-operating income from sources other than within this State and deducted therefrom miscellaneous operating expenses within the State and a proportionate part of all deductions from gross income as set forth in the Interstate Commerce Commission classification of accounts based upon the proportionate average of operating expenses for their whole business."